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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

C:PSI:B04

PLR-139005-12

Date:

February 26, 2013

Legend

Decedent	=
Spouse	=
Son	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Spouse's Trust No. 1	=
Spouse's Trust No. 2	=
Family Trust	=
Exempt Trust	=
Nonexempt Trust	=
Son's Trust	=
State	=
Court	=
Citation	=

Dear :

This letter responds to a letter dated September 6, 2012, and supplemental correspondence, submitted by the authorized representatives of Exempt Trust, requesting rulings regarding the gift, estate, and generation-skipping transfer (GST) tax consequences of proposed distributions from Exempt Trust to Son's Trust.

The facts and representations submitted are summarized as follows:

Decedent executed his will on Date 1 and amended his will on Date 2. Date 1 and Date 2 are dates occurring prior to October 22, 1986. Decedent's will established three trusts at his death: Spouse's Trust No. 1, Spouse's Trust No. 2, and Family Trust.

Decedent died on Date 3, a date occurring after January 1, 1987. By order of Court entered on Date 4, Spouse's Trust No. 1 was divided into two trusts (Exempt Trust and Nonexempt Trust).

Decedent's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return was timely filed. Decedent's estate made an election under § 2056(b)(7) of the Internal Revenue Code (Code) to treat the property of Spouse's Trust No. 1 as qualified terminable interest property (QTIP). Decedent's estate also made a reverse QTIP election under § 2652(a)(3) of the Code with respect to Exempt Trust and allocated Decedent's available GST exemption to Exempt Trust. It is represented that Exempt Trust has an inclusion ratio of zero for purposes of Chapter 13 of the Code.

Clause Eleventh, paragraph E of Decedent's will provides for the distribution at Wife's death of assets remaining in Spouse's Trust No. 1 (therefore, Exempt Trust and Nonexempt Trust), Spouse's Trust No. 2, and Family Trust. Clause Eleventh, subparagraph E(2) provides for the distribution, upon Wife's death, (1) to a separate trust for the benefit of Son (Son's Trust), of assets having a fair market value of Two Hundred Fifty Thousand Dollars (or the entire balance of assets remaining after the distribution provided for in E(1) if the balance has a fair market value less than Two Hundred Fifty Thousand Dollars), and (2) to Son outright of the excess, if any.

Clause Eleventh, subparagraph E(3) of Decedent's will provides:

3. If at the death of the survivor of my wife and myself, an amount other than Two Hundred Fifty Thousand is specified in Section 2613(b)(6) of the Internal Revenue Code as then in effect, the amount so specified in the Code shall be substituted for the above mentioned sum of Two Hundred Fifty Thousand Dollars in the first sentence of subparagraph E 2 of this Clause Eleventh of my Will.

With regard to Son's Trust, Clause Eleventh, subparagraph E(2)(a) of Decedent's will provides for the accumulation of trust income or distribution of the current and accumulated income to Son and his issue, during Son's lifetime, as trustees deem wise. Clause Eleventh, subparagraph E(2)(b) provides for distribution of the trust principal as trustees (other than Son) deem wise to Son for purposes of purchasing a home, starting a business, or providing for emergency needs of Son or his issue. Clause Eleventh,

subparagraph (E)(2)(c) provides that, upon Son's death, the principal and undistributed income then remaining in Son's Trust shall be distributed to or for the benefit of Son's children as Son may appoint in his will, provided, however, that Son's power of appointment may be exercised only in such manner as to cause the trust property to be includible in the gross estates of one or more of Son's children.

Wife died on Date 5. Thereafter, Exempt Trust filed a Petition for Adjudication with Court to resolve an ambiguity in Decedent's will regarding the amount to be distributed from Exempt Trust to Son's Trust after Wife's death. Court concluded that Clause Eleventh, subparagraph E(3) of Decedent's will is ambiguous because it contains a reference to a provision of the Code that has been repealed since the date Decedent signed his will. After considering the language of Decedent's will, Decedent's scheme of distribution, the circumstances surrounding Decedent at the time he executed his will, and other existing facts, including Code provisions then in effect, Court concluded that Decedent intended to take full advantage of the GST exemption available at Decedent's death.

On Date 6, Court issued an order instructing the trustees of Exempt Trust to distribute all of the principal and income of Exempt Trust (an amount exceeding \$250,000) to Son's Trust, to be held under the terms of Clause Eleventh, subparagraph E(2) of Decedent's will.

Exempt Trust requests the following rulings:

1. The distribution of Exempt Trust assets to Son's Trust will not cause the inclusion ratio of Son's Trust to be greater than zero under § 2642.
2. The distribution of Exempt Trust assets to Son's Trust will not be deemed to be a transfer by Son that will be subject to federal gift tax under § 2501.
3. The distribution of Exempt Trust assets to Son's Trust will not cause any property of Exempt Trust or Son's Trust to be includible in the estate of Son under § 2036 or § 2038.

LAW AND ANALYSIS

Ruling 1

Section 2601 of the Code imposes a tax on every generation-skipping transfer (GST) made after October 22, 1986. A GST is defined under § 2611 as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (the Act), and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(B) of the Act and § 26.2601-1(b)(2)(i), the tax does not apply to a transfer under a will executed before October 22, 1986, if the decedent dies before January 1, 1987.

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b)(1), (b)(2), or (b)(3), will not cause the trust to lose its exempt status. Generally, unless specifically provided otherwise, the rules of § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the provisions of chapter 13, if: (1) The judicial action involves a bona fide issue; and (2) The construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(i)(E), Example 3, considers a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of A and B, or per capita among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates. The court's construction resolves a bona fide issue regarding the proper interpretation of the instrument and is consistent with applicable state law as it would be interpreted by the highest court of the state. Therefore, the trust will not be subject to the provisions of chapter 13.

In Comm'r v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be

controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving “proper regard” to the state trial court’s determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

The State Supreme Court stated that “[i]t is now hornbook law (1) that the testator’s intent is the polestar and must prevail; and (2) that his intent must be gathered from a consideration of (a) all language contained in the four corners of his will and (b) his scheme of distribution and (c) the circumstances surrounding him at the time he made his will and (d) the existing facts.” Citation.

It is represented that the executor of Decedent’s estate allocated sufficient GST exemption to Exempt Trust to cause Exempt Trust to have an inclusion ratio of zero under § 2642. No guidance has been issued concerning judicial constructions that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a judicial construction that would not affect the GST status of a “grandfathered trust” should similarly not affect the exempt status of such a trust.

In this case, the trustees of Exempt Trust filed a Petition for Adjudication with Court to resolve the ambiguity in Decedent’s will regarding the amount to be distributed from Exempt Trust to Son’s Trust after Wife’s death. Court issued an order construing Decedent’s will to provide for distribution of all of the assets of Exempt Trust (rather than \$250,000) to Son’s Trust, a successor trust established under the terms of Decedent’s will. Court’s construction resolved a bona fide issue regarding the proper interpretation of Decedent’s will. In addition, Court based its construction on Decedent’s intent at the time of making his will, and Court reached its construction after considering the language of Decedent’s will, his scheme of distribution, the circumstances surrounding him at the time he executed his will, and other existing facts, including the tax consequences of relevant provisions of the Code. Therefore, Court’s construction is consistent with applicable State law as it would be interpreted by the highest court of State.

Accordingly, we conclude that to the extent assets of Exempt Trust are distributed to Son’s Trust, the distribution will not cause the inclusion ratio of Son’s Trust to be greater than zero under § 2642.

Ruling Request 2

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by an individual.

Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether property transferred is real or personal, tangible or intangible.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

In this case, Decedent is the transferor with respect to the assets in Spouse's Trust No. 1 (therefore, Exempt Trust and Nonexempt Trust). The judicial construction providing for the distribution of all of the assets of Exempt Trust to Son's Trust does not result in a transfer by Son. The beneficiaries of Son's Trust will have the same interests after the judicial construction that they had prior to the judicial construction. Because the beneficial interests of the beneficiaries are substantially the same, no transfer of property will be deemed to occur as a result of the judicial construction. Accordingly, based on the facts submitted and the representations made, we conclude that the distribution of Exempt Trust assets to Son's Trust will not be deemed to be a transfer by Son that will be subject to federal gift tax under § 2501.

Ruling Request 3

Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2036 provides that the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death – (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2038 provides (with respect to transfers made after June 22, 1936) that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable)

by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or whether any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In this case, Decedent is the transferor with respect to the assets in Spouse's Trust No. 1 (therefore, Exempt Trust and Nonexempt Trust). The judicial construction providing for the distribution of all of the assets of Exempt Trust to Son's Trust does not result in a transfer by Son. Accordingly, based on the facts submitted and the representations made, we conclude that the distribution of Exempt Trust assets to Son's Trust will not cause any property of Exempt Trust or Son's Trust to be includible in the estate of Son under § 2036 or § 2038.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

James F. Hogan
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes

cc: